UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

Tennessee Gas Pipeline Company | Docket Nos. RP96-312-017, RP96-312-025, and RP96-312-026

ORDER ON REHEARING

(Issued November 21, 2001)

Indicated Shippers has requested rehearing of the Commission's May 26, 1999 order in Docket No. RP96-312-014, et al., [1] Indicated Shippers, Amoco Energy Trading Corporation and Amoco Production Company (filing jointly as Amoco) have requested rehearing of the Commission's October 13, 1999 order in Docket No. RP96-312-018, et al., [2] and Indicated Shippers has requested rehearing of the Commission's November 23, 1999 order in Docket No. RP96-312-018, et al. [3] Those orders, among other things, accepted for filing, a number of letter agreements submitted by Tennessee Gas Pipeline Company (Tennessee) containing early termination provisions. Indicated Shippers and Amoco argue that the early termination clauses are not negotiated rates but rather are prohibited negotiated terms and conditions of service. For the reasons discussed below, the Commission denies the requests for rehearing because they are moot. This order is in the public interest because it clarifies our regulations and policies regarding non-conforming contracts so that parties are clear about contracting practices that we find unacceptable because they present a significant potential for undue discrimination, and those that we find acceptable because they can be permitted without substantial risk of undue discrimination.

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[1] 87 FERC ¶ 61,206 (1999).

[2] 89 FERC ¶ 61,033 (1999).

[3] 89 FERC ¶ 61,205 (1999).

Background

On April 30, 1999, in Docket No. RP96-312-017, Tennessee submitted for filing a contract for transportation service to be provided to Caledonia Power I, L.L.C. (Caledonia). One of the provisions of that contract accorded Caledonia the right annually to buy out the last calendar years of its firm transportation contract in accordance with a prescribed schedule and payments depending on the year of the buyout. Indicated Shippers filed a protest arguing that the buyout provision constituted a negotiated term or condition of service rather than a negotiated rate. In the May 26, 1999 order, the Commission rejected the Indicated Shippers' protest, stating: [4]

> The Commission disagrees with the contention that a contract buyout provision is a negotiated term and condition of service. Caledonia has agreed to pay a negotiated rate in exchange for the ability to terminate the service early. The provision will not change the character of the service provided, or the operational conditions of service; nor will it affect service to any other shipper or to Tennessee's operations generally. This provision is only an agreement to pay a negotiated amount for service in the event of early termination. It covers the only two provisions that can be negotiated: the rate and the term of the agreement. It is, therefore, a permissible negotiated rate provision, and is not a prohibited negotiation of the terms and conditions of service.

On September 20, 1999, in Docket No. RP96-312-018, et al., Tennessee filed copies of four agreements with Berkshire Gas Company (Berkshire), and an amended tariff sheet listing the agreements. The public version of the filing included three separate service agreements, amended by three nonconforming service agreements, all dated September 15, 1999. The filing also included a "Contract Restructuring Letter Agreement" (Letter Agreement) that was filed with the Commission under seal and not included in the public version. The Letter Agreement extended the terms of the service agreements for four years, beginning November 1, 1999. [5] The September 15 nonconforming agreements would allow Berkshire to terminate the contracts prior to the expiration of the extended term, subject to 12 months notice and a buyout payment. The nonconforming agreements provide Berkshire the right to terminate its contracts in the event the Massachusetts Department of Telecommunications and Energy or any equivalent entity issues a final order requiring Berkshire to reduce the amount of firm transportation or firm storage service. The agreements also provide Berkshire the option

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[4] 87 FERC at 61,789.

[5] The service agreements otherwise provided for expiration on November 1, 2000.

to reduce up to 100 percent of its total quantity any given year during the primary extended term of the contract. Indicated Shippers and Amoco protested the September 20 filing, contending that the buyout provisions constituted negotiated terms and conditions of service that alter the character of the pro forma service agreement by reallocating the risk between Tennessee and the Shipper. As a consequence, they argued that those provisions constituted prohibited negotiated terms and conditions of service. In the October 13, 1999 order, the Commission, relying on its May 26, 1999 order, found that Amoco's and Indicated Shippers' arguments were without merit. However, the Commission conditionally accepted the Letter Agreements pending parties' comments on the Letter Agreements after the Commission determined that they did not warrant confidential treatment.

In the Commission's November 23, 1999 order in Docket No. RP96-312-022, et al., the Commission accepted the Letter Agreements without condition. It rejected Indicated Shippers' contention that the Rate Zone Turnback provisions in the subject letter agreements were negotiated terms and conditions of service that departed from Tennessee's pro forma Rate Schedule FT-A service agreement. These provisions would allow the shipper to reduce its service entitlement in particular rate zones upon the payment of sum of money similar to buyout provisions. The Commission found that the Rate Zone Turnback provisions were not impermissible terms and conditions of service.[6]

Requests for Rehearing

In requesting rehearing of the May 26, 1999 order, Indicated Shippers argue that (1) the Commission erred in approving a contract for service that is unduly discriminatory and preferential; (2) the Commission erred in approving a contract that contains a negotiated term and condition of service despite its policy prohibiting such terms; and (3) the Commission should clarify on rehearing that Tennessee may not seek to reflect in its next rate case any discount adjustment based upon the discounted reservation charge under the subject contract.

In requesting rehearing of the October 13, 1999 order, Amoco contends that the Commission erred in: (1) determining that the buyout and turnback provisions are negotiated rates rather than negotiated terms and conditions of service; (2) failing to adhere to its Policy Statement, which prohibits negotiated terms and conditions of service; and (3) approving the buyout and turnback provisions without requiring that they be incorporated into Tennessee's tariff and made available to others. Indicated Shippers

[6] 89 FERC at 61,625.

similarly argue that the Commission erred: (1) in accepting contracts reflecting negotiated terms and conditions of service; (2) in departing from its policy against permitting negotiated rate shippers greater ability than recourse shippers to obtain and retain service; and (3) in effectively applying a proposed rule in an individual adjudication when the proposed rule has not been promulgated.

Finally, in requesting rehearing of the Commission's November 23, 1999 order, Indicated Shippers maintain that the Commission: (1) erred in approving contracts subject to the Natural Gas Act that are unduly discriminatory in that they provide to selective shippers valuable flexibility not generally available to other shippers under the same rate schedule; (2) acted arbitrarily and capriciously in accepting contracts containing negotiated terms and conditions of service without providing any meaningful, objective criteria from distinguishing between permissible"material deviations" under Section 154.1(d) of the Commission's regulations and prohibited negotiated terms and conditions of service; (3) erred in departing without explanation from its own prior orders and policies by approving contracts that include negotiated terms and conditions of service which deviate from the pro forma service agreement without requiring Tennessee to either make the negotiated provision generally available to all shippers under the same rate schedule, or provide an adequate justification for refusing to make the negotiated provision generally available; and (4) erred in failing to place Tennessee at risk in a future rate case for capacity that could be stranded as a result of these agreements, even though Tennessee would receive and retain lump-sum buyout payments from the shippers.

Discussion

Before addressing the specific arguments made by the parties in the instant proceedings, a discussion concerning what constitutes a material deviation and the Commission's review of nonconforming contracts is helpful to put the issues in their proper context.

1. What constitutes a material deviation

As discussed more fully in our contemporaneous order in ANR Pipeline Company, Docket No. RP00-300-000, under current Commission policy, to the extent a capacity adjustment provision of a service agreement such as is at issue here materially deviates from the Form of Service Agreement, the Agreement must be filed for Commission review.

The reason for this filing obligation is that, where the service agreement contains a provision not in the approved language of the Form of Service Agreement and that provision (1) goes beyond filling in the blank spaces with the appropriate information allowed by the tariff and (2) affects the substantive rights of the parties, the Commission cannot be considered to have already reviewed the service agreement when it reviewed the pro forma service agreement. Because it contains a provision affecting the substantive rights of the parties which the Commission has never seen before, and since NGA section 4 requires the filing of all contracts which affect the pipeline's service "in any manner," the statute requires the filing of such a service agreement.

The Commission interprets the section 154.1(d) which requires the filing of any contract that "deviates in any material aspect from the Form of Service Agreement," as follows: A material deviation is any provision of a service agreement which goes beyond filling in the spaces in the Form of Service Agreement with the appropriate information[7] provided for in the tariff, and that affects the substantive rights of the parties. Therefore, §154.1 requires the filing of any service agreement which contains a material deviation of this type.

Matters such as early termination provisions affect the rights of the customer in whose service agreement such a provision might be contained, and could raise issues as to discrimination among customers. Allowing pipelines to include such provisions in the service agreements of customers without any review by the Commission either as part of the pro forma service agreement or the review of an individual service agreement would be contrary to the section 4 requirement that pipelines file contracts affecting service "in any manner." In the instant case, Tennessee recognized that the early termination provisions in the subject service agreements constituted material deviations from the form of service agreements and properly filed the agreements for Commission review.

2. Commission review of non-conforming agreements

Once a service agreement has been found to deviate materially from the Form of Service Agreement and the tariff so that it must be filed for Commission review, a further issue arises as to whether the Commission should approve the non-conforming agreement. That is the issue raised by the instant rehearing requests. The Commission finds that material deviations from the Form of Service Agreement fall into two general categories --those that must be prohibited because they present a significant potential for undue discrimination among shippers and those that can be permitted without substantial risk of undue discrimination.

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[7]Specifically, we mean information that is appropriate when read in context with the surrounding language of the Form of Service Agreement.

One category of material deviation that is generally not permitted is negotiated terms and conditions of service. The Commission determined in Order No. 637 not to provide pipelines with the authority to file for pre-approval of the right to negotiate terms and conditions of service with individual customers, because of the risk of undue discrimination among customers. In Order No. 637, the Commission stated that it generally considers negotiated terms and conditions to be related to operational conditions of transportation service. Order No. 637 gave as examples of such conditions, "scheduling, imbalances, or operational obligations such as OFOs." [8] Subsequently, the Commission has held that negotiated terms and conditions of service include any provisions that result in a customer receiving a different quality of service than that provided other customers under the pipeline's tariff [9] or that affect the quality of service received by others. Consistent with Order No. 637, where a material deviation in a non-conforming contract constitutes a negotiated term and condition of service, the Commission would require that the pipeline modify its tariff to offer the negotiated service to all its customers or explain why it can only provide the service to this one customer.

However, not every material deviation from a pro forma Form of Service Agreement entails such a risk of undue discrimination that it cannot be permitted. For example, the Commission has permitted pipelines to negotiate rates that deviate from those that are set forth in the pipeline's generally applicable rate schedules, so long as the shipper continues to have the option of choosing recourse service from the pipeline. [10] In Order No. 637, the Commission stated that permissible "negotiated rate agreements can include the price, the term of service, the receipt and delivery points, and the quantity." [11] However, as the policy statement on alternatives to traditional ratemaking emphasized, "the predicate for permitting a pipeline to charge a negotiated rate is that capacity is available at the recourse rate." [12] Therefore, as discussed further below, a key factor is determining whether to approve a material deviation agreed to as part of a negotiated rate

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[8] Order No. 637, III FERC Stats & Regs. ¶ 31,300 at 31,344.

[9] See Dominion Transmission, Inc., 93 FERC ¶ 61,177 (2000).

[10] Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, and Regulation of Negotiated Transportation Services of Natural Gas Pipelines, 61 Fed. Reg. 4633 (February 7, 1996), 74 FERC ¶ 61,076 (1996).

[11] Order No. 637, III FERC Stats & Regs. ¶ 31,300 at 31,344.

[12] 74 FERC at 61,241.

agreement is the extent to which the option of obtaining service at the recourse rate is an adequate alternative.

In addition, there are other material deviations that may be negotiated with an individual shipper to address its unique characteristics, without affecting the quality of service received by that shipper or others. For example, the Commission recently approved a provision in a service agreement with a limited partnership that exculpated the individual partners from liability for actions of the partnership. [13]

Application of Commission Policy to Buyout Provisions

Applying the above analysis to the contracts between Tennessee and its customers at issue here, we find that the early termination provisions present too much potential for undue discrimination unless they are offered in the pipeline's tariff pursuant to generally applicable conditions. A shipper's right to reduce, or terminate, its contract demand before the expiration of its contract is a valuable right, since it can enable the shipper to avoid significant liability for future reservation charges. Such a valuable right must be granted in a not unduly discriminatory manner.

While a pipeline may place reasonable conditions on the negotiation of contract demand reduction rights, [14] such conditions must not be unduly discriminatory. The Commission finds that requiring pipelines to file generally applicable tariff provisions setting forth the conditions under which they will offer contract demand reduction rights is the best means of assuring that those rights will be negotiated in a not unduly discriminatory manner. Such a tariff filing would give the Commission and other interested parties an opportunity to review the circumstances in which the pipeline will offer contract demand reduction rights. Also, once approved, the tariff provision will require the pipeline to grant similar rights to similarly situated customers.

It is true, as Order No. 637 stated, that negotiated rate agreements can include not only the price, but also the term of service, the receipt and delivery points, and the quantity. Such provisions are necessary to define the service to be received at the negotiated rate. In our previous orders in these proceedings, we found the contract

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[13] ANR Pipeline Company, 97 FERC ¶ 61,075 (2001).

[14] For example, it may be reasonable for a pipeline to tie contract demand reduction rights to certain events, such as the closure of the plant being served by a particular contract or, in the case of an LDC, a loss of customers through retail unbundling or a bypass.

demand reduction and early termination provisions in the subject letter agreements to be permissible negotiations of the rate and term of the agreements. However, we have reconsidered that holding.

The linchpin of the Commission's negotiated rate policy is that a customer not satisfied with the negotiated rate offered by the pipeline for the amount of service requested by the shipper can always obtain available capacity at the Commission-determined just and reasonable recourse rate. Where a customer is seeking service for a set contract term and quantity, the recourse service does provide an adequate alternative. If a mutually agreeable rate cannot be agreed upon, the shipper can always obtain the same service at the recourse rate for the same contract term and quantity. However, if the customer desires a special contract demand reduction or early termination right not provided in the generally applicable tariff, the availability of service at the recourse rate does not provide an adequate substitute, since recourse service would not include any such provision. A shipper obtaining such a buyout provision would be automatically insulated from the risk of not being able to terminate its service agreement early, and therefore, would have an advantage over recourse rate shippers. It is, therefore, our conclusion that pipelines should not be permitted to negotiate such provisions, unless they are offered, subject to reasonable conditions, as part of the pipeline's generally applicable tariff.

Tennessee's Subsequent Tariff Filing

While we have reconsidered our holdings in the May 26, October 13, and November 23, 1999 orders that early termination provisions are permissible as part of negotiated rate agreements, we find that subsequent developments have rendered the requests for rehearing of those orders moot. On May 24, 2000, Tennessee filed tariff sheets to revise certain aspects of its Net Present Value (NPV) method for evaluating bids for newly available capacity. In that filing, Tennessee proposed to include a termination option as part of its tariff. To determine the NPV of a bid with an option allowing the bidder to terminate the service agreement or to reduce the contract demand, Tennessee would only consider the minimum incremental revenue to be generated if the option is not exercised, including any exit payment. Tennessee also proposed to amend its pro forma service agreement to provide for termination options, with blanks for the buyout period, transportation quantity to be reduced, amount of buyout payment, etc. to be filled in when the contract is executed. However, Tennessee proposed to reserve the right to use its business judgement in determining whether to accept an otherwise winning bid which contains a termination option that could only be exercised following an order from a state regulatory commission.

In an order issued June 23, 2000, in Docket No. RP00-300-000, the Commission found that this reservation of right would allow for an unlimited and unjustified exercise of discretion by Tennessee in deciding, after bids have been received, which bids may be acceptable. [15] The Commission held that if Tennessee wished to accept or decline bids with such termination options, Tennessee must make that determination before posting the capacity, and must so specify in its posting. [16] The Commission directed Tennessee to revise its tariff proposal accordingly. In its compliance filing, Tennessee revised Section 5.2 of its FERC Gas Tariff to provide that Tennessee will list in its open season posting acceptable terms for any reduction option.

The essence of the objections voiced in the rehearing requests of the May 26, October 13, and November 23 orders in the instant proceedings is that the Commission erred: (1) in accepting contracts for service that were unduly discriminatory and preferential, (2) failing to adhere to its Policy Statement which prohibits negotiated terms and conditions of service, and (3) approving the buyout and turnback provisions without requiring that they be incorporated into Tennessee's tariff and made available to others.

Tennessee's filing in Docket No. RP00-300-000 effectively moots those concerns. When Tennessee posts available capacity during its open season, it will also list acceptable terms for any reduction option. Thus, in contrast to the situation when the Commission originally acted on the subject service agreements, Tennessee's tariff now provides that, each time Tennessee posts capacity for sale, potential shippers will have the same buyout or contract reduction option available. This satisfies our concern that contract demand reduction or termination provisions be made available to all customers seeking capacity on a non-discriminatory basis. Accordingly, rehearing of the May 26, 1999, October 13, 1999, and November 23, 1999 orders in the instant proceedings are denied as moot.

Discount Adjustment

In requesting rehearing of the Commission's May 26, 1999 order in Docket No. RP96-312-014, Indicated Shippers urge the Commission to clarify that Tennessee may not reflect in its next rate case any discount adjustment based on the discounted reservation charge under the subject contract. Similarly, in its request for rehearing of the Commission's November 23, 1999 order, Indicated Shippers' argue that the Commission erred in failing to place Tennessee at risk in a future rate case for capacity that could be

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[15] Tennessee Gas Pipeline Company, 91 FERC ¶ 61,292 at 62,009. (2000).

[16] Id.

stranded as a result of these agreements, even though Tennessee would receive and retain lump-sum buyout payments from the shippers.

In our May 26, 1999 order, the Commission observed that the agreement between Tennessee and the shipper was a negotiated rate transaction, and that Tennessee will be at risk for any cost underrecovery associated with the agreement. We believe that we have adequately addressed the issue of Tennessee's obligation in the event of a cost-underrecovery. [17]

In the November 23, 1999 order, with regard to the stranded cost issue, the Commission found that since Tennessee was precluded from making another general rate case filing for several years, it is premature to rule at this juncture on any rate implications of the subject letter agreements. [18] Indicated Shippers have advanced no argument that warrants a different conclusion here. Accordingly, rehearing on this issue is denied.

The Commission orders:

The requests for rehearing are denied as discussed above.

By the Commission.

(S E A L)

David P. Boergers,
Secretary.

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[17] 87 FERC at 61,790.

[18] 89 FERC at 61,626.